

VZCZCXRO6094
RR RUEHIK
DE RUEHKV #1834/01 2941458
ZNR UUUUU ZZH
R 211458Z OCT 09
FM AMEMBASSY KYIV
TO RUEHC/SECSTATE WASHDC 8633
INFO RUCNCIS/CIS COLLECTIVE
RUEHZG/NATO EU COLLECTIVE
RHEHAAA/NSC WASHDC
RUEHRC/USDA FAS WASHDC
RUCPDOG/USDOC WASHINGTON DC
RUEHRC/USDA WASHDC

UNCLAS SECTION 01 OF 05 KYIV 001834

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AND
ITA/MAC/EEUR/JBROUGHER/CLUCYK

E.O. 12958: N/A
TAGS: [ETRD](#) [EAGR](#) [PREL](#) [USTR](#) [UP](#)
SUBJECT: EU-UKRAINE FTA: STILL A WAYS OFF

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SENSITIVE BUT UNCLASSIFIED

11. (U) Summary. President Yushenko's recent statements indicating that the EU and Ukraine could complete negotiations on a Free Trade Agreement (FTA) in the next few months are at odds with the assessments of both the EU and Ukrainian negotiators. Furthermore, the president's suggestion that Ukraine could sign an Association Agreement with the EU in advance of finalizing details of an FTA seem unrealistic, and contrary to stated EU positions. Nonetheless, Ukraine is pushing ahead, with its new Foreign Minister in the lead, looking to make as much progress as possible by the end of the year to bind Ukraine closer to the European Union. This cable reports on the FTA negotiations and specific problem areas in the negotiations. End Summary.

Background

12. (U) In an effort to further integrate Ukraine into the economic networks of Europe, the European Union (EU) is negotiating a Free Trade Agreement (FTA) with Ukraine. This is the most ambitious trade agreement the EU has ever entered into with a non-member state, going beyond the system of preferences worked out with other non-member trading partners. The FTA envisions a harmonization of Ukraine's trade laws, product safety standards, and inspection regime with those of the EU, as well as the elimination of all defensive trade barriers. The creation of the FTA will not be an easily realized goal. The negotiations are already behind schedule, and Ukraine lacks the funds to implement the full range of changes required by EU trade laws and safety regulations. Moreover, GOU negotiators have doubts that a truly unrestricted trade agreement would have enough political support to be ratified.

13. (U) Further political and economic integration of Ukraine and the European Union is a priority for President Yushenko, and he regards the signing of a Free Trade Agreement with the EU as a fundamental step towards that goal. To get a better picture of the progress being made towards adoption of an EU-Ukraine FTA, Embaffs spoke with Valeriy Piatnytskiy, First Deputy Minister of Economy and European Integration at the Ministry of Economy, Pavlo Klimkin, Director of the EU Department at the Ministry of Foreign Affairs, and Ulrike

Timeline

¶4. (SBU) The original target date for the signing of the FTA was December 2009, but this has slipped to mid-2010. Deputy Piatnytskiy stated that his focus was on getting an agreement that could be ratified by the Verkhovna Rada, Ukraine's parliament, even if that meant taking additional time. He did not expect completion by the end of the year. Director Klimkin said that the timeline is up in the air, due to the difficulties in working out conceptual differences. He stated that the Verkhovna Rada is not ready to give concessions in key areas. From the EU viewpoint, however, if the GOU cannot come to agreement on the FTA by a mid-2010 deadline, then Ukraine's seriousness about its intentions will come into question.

¶5. (U) On October 13th, President Yuschenko restated his hopes that Ukraine would conclude an Association Agreement with the European Union by December 2009, in time for the Ukraine-EU Summit. Possibly recognizing the difficulties of concluding an FTA with the EU in such a short time frame, President Yuschenko further stated that the Ukraine-EU FTA negotiations should be completed a few months later, effectively splitting the two. However, the EU's longstanding policy position is that the FTA is an integral part of the Association Agreement and a pre-requisite to the Association Agreement. Media reports indicated that the Ministry of Foreign Affairs was taken by surprise by Yuschenko's announcement of a December target date for signing of the

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Association Agreement. Some speculated that this may be a move by Yuschenko to discredit the new Foreign Minister, Pyotr Poroshenko, purportedly a current ally of Prime Minister Tymoshenko (despite earlier close ties to Yuschenko), by giving him an impossible deadline.

Scope

¶6. (U) Representatives of the GOU see the FTA as a means to remove barriers to the free movement of goods, services, capital, investment and persons between Ukraine and the EU. For its part, the EU is focusing on the elimination of defensive trade measures and bringing Ukrainian product safety standards up to EU levels.

Expected Benefits

¶7. (U) In an ideal world, the EU would expect to: gain broad market access to Ukraine; eliminate excessive business registration requirements for EU members doing business in Ukraine; ensure that EU members operating in Ukraine have the protection of a transparent legal system; and gain competitive access to the GOU's public procurement market. While these goals will be negotiated into the treaty, interlocutors all note that full implementation will be a long-term project.

¶8. (U) For its part, Ukraine views the FTA as a means to develop its economy by gaining access to European markets, but also by forcing upgrades to its business environment, which will eventually allow for increasing foreign investment. The main objective of Ukrainian agribusinesses is to get into the supply chains of the major European supermarkets. In the short term, Ukraine foresees benefits for specific product exports, such as grain, sunflower oil, and poultry, which command higher prices on the EU markets

than domestically.

¶9. (SBU) Post notes, however, that increased exports in the specified categories are unlikely to result from an FTA. Ukraine's sunflower oil is already exported to the EU in large quantities without an FTA, and it has little competition due to GOU-imposed price controls that make it artificially undervalued. The same is true for grain, which is also heavily traded to the EU without an FTA. Meat is a different story. Ukraine's poultry industry failed an EU inspection earlier this year, and without substantial improvements, Ukraine would not be able to export to the EU even under an FTA. The beef industry is presently being inspected, but given dwindling herd sizes and Ukraine's present status as a beef importer, it is difficult to envision Ukrainian meat reaching EU markets in significant quantities until production levels increase substantially.

Negotiation Points

¶10. (U) The EU seeks to secure equal access to compete for GOU contracts. However, GOU representatives believe the Rada would not ratify the FTA if it included strong government procurement provisions, which would threaten entrenched interests.

¶11. (U) The EU's environmental protection regime is far more stringent than Ukraine's, and GOU representatives state that harmonizing Ukraine's legal code and enforcement capabilities will place a severe fiscal burden on the budget, making this an area of difficulty in the negotiations. Interlocutors note the need to train inspectors and business interests, for example, as a major undertaking that has not yet begun.

¶12. (U) The EU is inclined to push Ukraine as far as possible on the issue of intellectual property rights protection, and wants to harmonize Ukrainian law with EU legislation. The EU considers the negotiations to be at an advanced stage, though the GOU indicates that there are still technical difficulties

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to be worked out, mostly concerning the effort to bring Ukraine's legal code and IPR enforcement regime into alignment with EU standards.

¶13. (U) As part of the FTA, the EU wants geographical indicators held by EU members to be respected by Ukrainian manufacturers. This may negatively impact several Ukrainian wineries by denying them the right to make certain types of wine claimed as the exclusive property of EU member-state wine-making districts. Klimkin, for example, pointed out that every Ukrainian household pops a bottle of &Soviet Champagne8 on New Year's Eve. This is also seen as a difficulty by the GOU because there are very few internationally recognized Ukrainian products with geographical indicators.

¶14. (SBU) Implementation of EU-style Sanitary and Phyto-Sanitary (SPS) regulations will be difficult for the GOU. The GOU recognizes that it needs to make changes to conform to EU standards, but the funds required to do so are lacking. Director Klimkin estimates that to implement all SPS requirements in the more than two thousand EU laws and regulations that touch on SPS would cost Ukraine EUR 1 billion (USD 1.467 billion), based on the costs borne by Poland when they joined the EU as a full member. Bringing the inspection regime up to European standards would require training thousands of personnel, establishing testing laboratories in every village, and restructuring the whole system of veterinary control of food products. Overlapping authorities of various control agencies will need to be rectified. For example, the State Standards Committee is not a regulatory body, but it duplicates the regulatory functions of other government food control agencies. Before undertaking the effort to reform and upgrade their SPS

system, the GOU wants guarantees of market access, clear guidance from the EU on what needs to be done, and assistance from the EU on making the reforms.

¶15. (SBU) EU representatives view the SPS negotiations as one of the more difficult sections of the FTA. Conformity in standards is the goal) bringing Ukrainian safety standards up to EU levels. The EU has developed a number of analytical tools for use in this field, but the GOU complains that they lack the funds to make use of these instruments.

¶16. (SBU) A recent letter written from the European Commission to Economic Minister of Ukraine Danylyshyn warns Ukraine that current commitments on trade are already being ignored. The text of the letter admonishes the Ministry and expresses the opinion that Ukraine,s Veterinary Service Order 149, a meat and animal products measure notified to the WTO, but not yet in force, contradicts provisions already accepted in the SPS chapter of the FTA. In the letter, the Minister is advised that Ukraine,s adoption of such a measure would send a clear signal that Ukraine is unwilling to comply with its commitments.

¶17. (U) The EU would like to eliminate all defensive trade measures as part of the FTA. Since becoming a member of the WTO, Ukraine has submitted notification of 17 measures that qualify as technical barriers to trade (regulations and certification requirements for goods that serve as effective barriers to market entry).

¶18. (U) Ukraine would like to align itself with the Euro-Mediterranean approach on the Rules of Origin issue, which holds that only products that contain 80% or more of components originating in Ukraine will benefit for the FTA, restricting third-party countries from using Ukraine as a conduit into the EU market.

¶19. (U) As part of the FTA negotiations, the GOU expects to obtain EU cooperation in upgrading its energy and transportation infrastructure to facilitate the movement of freight and fuel between the two parties.

¶20. (SBU) GOU representatives told Emboffs that the current EU agriculture proposal is not acceptable for Ukraine, as Ukraine,s export opportunities to EU member states would still be governed by quotas similar to those on neighboring

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Belarus. The GOU wants its agribusinesses to export meat, poultry and eggs to the EU without restriction, or at least with higher quotas than non-FTA members.

¶21. (U) The EU and GOU are just beginning their negotiations on tariff reduction. Their eventual goal is to reduce all tariffs on trade goods to zero. One part of the negotiations will involve determining a schedule for the gradual elimination of the tariffs. The presence of government subsidies makes this process more complicated, due to the need to add counterbalancing surcharges.

¶22. (U) Details also remain to be worked out on how to monitor implementation and settle disputes under the Free Trade Agreement.

EU Technical Assistance

¶23. (SBU) Director Klimkin told Emboffs that the current level of technical assistance being provided by the European Union is not enough, and that for proper implementation of the FTA, it will need to be increased five or six times, to the same level of sustainable assistance received by the Baltic states. He stated that future assistance from the EU should be revised to be more effective and better coordinated. At present, technical assistance is provided on an ad hoc basis by individual EU members, and, while the GOU

appreciates the efforts, Klimkin feels that EU technical assistance would be more effective if EU member-states pooled their money and coordinated their programs through a central agency.

¶24. (U) The EU has 60 people in Ukraine working on technical assistance in support of the FTA. They are working with the GOU to harmonize Ukraine,s regulations with those of the EU in the areas of technical standards, food safety, trade barriers, competition policy, and intellectual property rights.

Barriers to Implementation

¶25. (SBU) Administratively, implementation of an EU-harmonized safety inspection regime would require close coordination between the Ministry of Health, Ministry of Agrarian Policy, the State Veterinary Service of Ukraine and other ministries. This presents a problem for the GOU, according to Klimkin, as its bureaucracy is only slightly upgraded from the legacy structure it inherited from the Soviet Union.

¶26. (U) As a precondition for access to the markets of the European Union via the Free Trade Agreement, Ukraine,s parliament would have to enact a large number of reforms. Given the sharp divides in Ukraine,s legislative assembly, passage of all required laws in a timely fashion will be a considerable challenge.

¶27. (SBU) Klimkin sees enforcement of EU-level regulations in Ukraine as a big problem. Not only does the GOU have to pass new laws, but judges and law enforcement agencies must enforce them at all levels. The GOU will need to take steps to ensure that the decisions made by Ukrainian courts are based on EU legislation) not just European Council directives but edicts of the EU Court of Justice as well. This has the potential to cause constitutional problems in the area of jurisdiction. Klimkin says that he hopes to make use of the EU,s judicial training programs to aid Ukraine,s judges in making proper decisions.

Effect on Relations with Russia

¶28. (SBU) Klimkin told Emboffs that the FTA with the EU will not impact Ukraine,s political relationship with Russia, which is presently governed by systematic points of conflict. Ukraine,s economic relationship with Russia remains strong, and there may be future joint projects towards further

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integration, depending on the outcome of Russia,s efforts to create a single economic space in the region. He added that diversification in trading partners is a good thing for Ukraine, and that the FTA is likely to divert Ukrainian trade from Russia to the EU, and attract more EU investors to Ukrainian opportunities, displacing Russians seeking acquisitions.

Public Sentiment

¶29. (SBU) Klimkin says that the Free Trade Agreement is not a high profile issue for Ukraine at present. The man on the street wants a visa, but doesn,t particularly care about trade with the EU. Ukraine,s business community is aware of the FTA and supports its implementation. Despite requiring significant political decision-making, the FTA has not received much attention from Ukraine,s political leaders. Klimkin opined that this was a good thing, since the negotiations could become much more difficult if the FTA were to become an issue in the presidential campaign.

¶30. (SBU) From the EU,s point of view, the low profile of the FTA in Ukraine is a problem. When the time comes to actually implement the political reforms mandated by the agreement, there will need to be a high level of public support for their enactment. This may prove to be an insurmountable problem for the GOU.

Comment

¶31. (SBU) Comment. While the FTA would be of immense benefit to Ukraine in the long term, it is still unclear whether the GOU will be able to muster the political will to implement the necessary upgrades to their infrastructure and reforms to their economic system. The EU is willing to provide some financial support and technical assistance, but their patience appears to be waning. If the GOU doesn,t make measurable progress in the near future, the prospects for the signing of the FTA may be in doubt. End comment.
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